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Financial Markets



Irving Trust

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The Federal Reserve was the focus of attention this week, as Chairman Volcker testified at the congressional monetary policy oversight hearings, and market participants assessed the Fed's open market operations for clues to its policy stance.

Mr. Volcker's Senate testimony, delivered on Tuesday, contained many of the points recorded in the minutes of the May 20 FOMC meeting: (1) the target ranges for monetary growth this year were left unchanged; (2) the narrower aggregates were predicted to be back within their target ranges by year-end; and (3) a suggestion was made that money growth might come in at the lower end of the ranges if the recent "unusual" behavior of money demand extends into the second half of the year. In addition, the Chairman reiterated the Committee's determination to pursue a reduced rate of monetary growth over the longer run; but in light of various technical problems concerning the introduction of nationwide NOW accounts, etc., no targets were specified for 1981 monetary growth. Indeed, the presentation left little doubt that the Fed, by its implied willingness to entertain a wide range of money growth rates this year, is currently giving greater weight to interest rates and less weight to the monetary aggregates targets. Since this had been known or suspected before, there was little market impact.

In contrast, the market was almost obsessed with the pattern of open market operations this week. Briefly, the Fed passed through to the market sizable numbers of customer RPs on Friday and Monday, as was expected in a week calling for a modest reserve add. Then on Tuesday, the Fed did reverse RPs when funds were trading at 8 1/4%. The best guess is that the draining operation was prompted by a revision of the Fed's reserve projections, probably centering on the behavior of float. In any event, the action caught the market by surprise, and earlier rate declines were rapidly reversed. On Wednesday, funds opened at 8 5/8% and had just begun to trade up to 8 7/8% shortly after noon, when the Fed offered its own RPs. In all likelihood this initiative was designed to counter an emerging reserve shortage, while simultaneously dispelling any lingering doubts concerning the Fed's policy stance well in advance of the Treasury's announcement of its refunding operation. From that point of view, the opportunity was golden. During the statement week beginning Thursday, there would be little chance to show the market an RP of any kind, since the Fed must drain a large amount of reserves to offset the impact of previously announced reductions in reserve requirements. As anticipated, the Fed began its reserve draining task by selling Treasury bills on Thursday.

The bottom line: for now, the Fed is willing to see funds trade in the middle of the 8%-9% range, but further easing over the next several weeks will be gradual, with the weekly average funds rate dropping by modest amounts, if at all. However, we continue to expect additional ease to be voted by the August 19 FOMC meeting.

William C. Melton



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Market Yields

	7/25/80 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	11.00%	11.50%	11.75%
Effective since	7/24/80		
Discount Rate at Federal Reserve Bank			
Federal Funds	11.00	11.00	10.00
Repurchase Agreements	8.63	8.75	10.63
	8.50	8.13	9.00
U.S. Treasury Issues			
Bills			
3 months	8.25	8.20	9.45
6 months	8.44	8.40	9.98
1 year	8.60	8.50	9.80
Coupons			
2 years	9.03	8.95	9.29
4 years	9.42	9.22	8.98
7 years	10.15	9.65	9.00
10 years	10.20	10.12	9.01
Long Bond	10.24	10.12	8.99
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.50	8.65	10.15
3 months	8.55	8.65	10.35
6 months	8.70	8.70	10.50
1 year	9.00	9.00	10.35
Banker's Acceptances			
1 month	8.50	8.60	10.15
3 months	8.50	8.55	10.40
6 months	8.45	8.65	10.60
Eurodollar Deposits			
1 month	8.88	9.00	11.00
2 months	8.94	9.13	11.06
3 months	9.06	9.25	11.06
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	7.00	6.00	9.50
1 month	8.38	8.38	9.90
3 months	8.38	8.38	9.63
Bank Holding Companies			
1 month	8.38	8.50	10.00
Dealer Placed:			
3 months	8.38	8.38	10.13
New AA Corporate Utility Bond	11.90	11.75	9.75
Tax Exempt			
6 month Project Notes	4.55	4.70	4.85
1 year AAA Bond	5.10	5.00	N/A
5 year AAA Bond	5.40	5.30	N/A
20 year AAA Bond	7.20	7.40	5.80

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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